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TREASURY FOR OASIA

E.O. 12958: N/A
TAGS: KTEX ETRD VN
SUBJECT: Vietnam: MOT Proposes Changes to Textile Quota Allocation Regime for 2005

¶1. This is a joint Embassy Hanoi/Congen Ho Chi Minh City message.

¶2. Summary: The Ministry of Trade (MOT) recently proposed changes to Vietnam's textile/garment quota allocation regime for 2005. The new regime would allocate quota based on factories' export revenue rather than on quantities (number of pieces) exported the previous year. Apparel firms worry that this will make it even more difficult to do business here in Vietnam. End summary.

The New Rule

¶3. The MOT, in coordination with the Ministry of Industry (MOI), issued a notice on March 16 announcing that it intended to change the basis for allocating textile quota in ¶2005. Rather than basing quota allocation on the previous year's export quantities, as it did for 75 percent of all quota allocated this year, in 2005 MOT plans to allocate quota based on the previous year's export revenues (for exports to quota-restricted countries such as the U.S. and the EU). The GVN also announced it would reserve ten percent of quota in some "hotly demanded" categories for contracts or orders with high prices. This would be the first time the GVN has based its allocation system on export revenues. Mr. Le Van Thang, Deputy Director of MOT's Export Import Department, acknowledged enterprises might face difficulties in adjusting to this new system. However, Mr. Thang stated he believes that only relatively few garment and textile enterprises will be disadvantaged by the new allocation system.

Reasons for the new rule

¶4. According to the announcement, the MOT is making the change to encourage higher value exports. The GVN has expressed its concerns that Vietnam's export capacity is much greater than the textile quota allotted by its biggest markets (primarily the U.S. and EU). MOT believes that encouraging factories to export higher-valued items will result in more efficient quota utilization. In 2003, Vietnam exported about USD 3.7 billion worth of textiles and garments to its quota- (total of about 40 million dozen) and non-quota (primarily Japan) markets. The GVN wants to increase textile and garment exports in 2004 by 16 percent to USD 4.2 billion. This will be difficult to achieve, as annual growth rates of quota arrangements Vietnam has with quota-restricting countries are significantly lower than 16 percent. (Note: The U.S. Vietnam bilateral textile agreement allows for seven percent annual growth (two percent for wool products.) End note.) Vietnam has a bilateral agreement with the EU that would increase textile and garment quotas 60 to 75 percent (depending on the category) this year. However, the EU has not actually allotted Vietnam the higher quota as yet because Vietnam has not implemented the commitments it made on banking sector liberalization for the EU in exchange for the larger quotas.

¶5. MOT is concerned that enterprises are using quota inefficiently, exporting low quality apparel at low prices. In the period immediately preceding negotiation of the U.S.-Vietnam bilateral textile agreement (starting in February 2003) the GVN actively encouraged Vietnamese enterprises to export as many textiles/garments to the U.S. as possible to expand the export basis upon which quota levels would be negotiated with the U.S. However, according to Mr. Thang, the GVN now wants enterprises "to pay more attention to quality and prices." The GVN believes that producing high-end textiles and apparel is the only way to make it competitive with China, especially when the Agreement on Textiles and Clothing (ATC) expires in 2005. The GVN also understands that its local producers, (rather than foreign invested enterprises), will be the ones most negatively affected by this new rule "which is painful, but needs to be done," according to Mr. Thang.

Enterprises ARE CONCERNED

¶6. Foreign apparel buyers and producers are critical of the new proposal. Representatives of HCMC companies told Econoff that it would likely make the system less transparent and would not have its intended effect - to increase the value of Vietnam's exports. On the contrary, they say, it will make Vietnam even less competitive in a world where apparel producers in other countries will no longer be bound by quota in 2005. They point out that much of the value in any garment (75 percent, on average) is the materials, most of which is imported into Vietnam. For most garments, only a small part represents the value-added in Vietnam -- typically the labor of cutting, making, and packing (CMP). Under the proposed system, clothing made with more expensive cloth will generate more quota, even if the Vietnam added value is the same or less. It also invites companies to inflate invoice prices in order to obtain more quota.

¶7. Firms are so concerned about the new proposal that the Vietnam Textile and Apparel Association (VITAS), which includes both Vietnamese and foreign-invested garment and textile firms, has invited the Vice Ministers of Trade and Industry responsible for textiles to Ho Chi Minh City next week to meet with them and air their views.

Even Bigger Worries

¶8. Foreign and private sector Vietnamese firms have expressed reservations about the GVN's quota allocation methodology. Foreign firms have been clear that they wish for the GVN to allocate as much quota as possible based on prior year performance, but in the last two years only 75 percent of quota was allocated that way. The rest of the quota was split up according to a variety of criteria such as increased capacity, additional investment, bonuses for remote and impoverished areas, big buyers, etc. Typically it was large state-owned firms that would meet the criteria for extra quota. This became particularly problematic this year, when as one foreign producer stated: 75 percent of this year's quota was allocated based on past performance, but past performance was based on last year's quota allocation in which only 75 percent of quota was based on past performance. So for this year, essentially, producers are getting 75 percent of 75 percent for past performance, which is closer to 56 percent.

¶9. The concerns about the quota system are underscored by larger worries about the viability of the garment business in Vietnam after the rest of the world goes quota free at the end of this year. One foreign producer noted that Vietnam should be simplifying the quota allocation system and reducing the cost of doing business to compete. High electricity and telecom costs (although telecom costs have fallen), and admin fees for quota (40-50 US cents/dozen) all raise the cost of doing business here for apparel producers. He also complained about costs surrounding customs hassles with importing fabric, in theory duty free if used in manufacturing export apparel. Although the trading rate for quota (to buy from another quota rights-holder) of $6-$12 per dozen is currently cheaper than in China, it is rising as quota becomes more scarce. When quotas disappear everywhere but Vietnam, firms producing in other countries will not need to pay this cost.

¶10. Private sector Vietnamese firms are also worried about the proposal. Mr. Diep Thanh Kiet, who owns a garment firm in HCMC and head's that city's association of garment producers, was also highly critical of the government's plan. He has also criticized the current allocation system as one designed to favor state-owned firms.

¶11. Comment: The recent proposal to shift quota allocation to a value- rather than volume-based system lacks specifics for implementation and appears to be more of a warning to firms to pay closer attention to quality and prices. Our contacts in HCMC believe the GVN can be persuaded not to implement the new system. Their concern about the overall competitiveness of Vietnam in a mostly quota-free world may be far more important. Over the past few years, companies doing business here have consistently said Vietnam represents a good alternative to China for sourcing apparel. However, after 2005, if Vietnam cannot stay competitive on price and speed, firms may question whether it is worth it to keep doing business in Vietnam.
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